E-015/M-90-211 APPROVING CONTRACT

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Darrel L. Peterson	Chair
Cynthia A. Kitlinski	Commissioner
Norma McKanna	Commissioner
Robert J. O'Keefe	Commissioner
Patrice Vick	Commissioner

In the Matter of Minnesota Power's Request for Approval of an Amendment to the Electric Service Agreement of Hibbing Taconite Joint Venture

ISSUE DATE: October 5, 1990

DOCKET NO. E-015/M-90-211

ORDER APPROVING CONTRACT

PROCEDURAL HISTORY

On April 2, 1990, Minnesota Power (MP) filed a petition seeking Commission approval of an amendment to its electric service agreement with Hibbing Taconite Joint Venture (Hibtac). Hibtac and MP had settled on a proposal to extend their existing contract in exchange for a cash payment.

On July 13, 1990, the Department of Public Service (the Department) filed a report recommending that the Commission approve the proposed amendment.

The matter came before the Commission on August 30, 1990.

FINDINGS AND CONCLUSIONS

HISTORICAL BACKGROUND

MP Large Power Customers

The Large Power (LP) class is designed for customers with demands of 10 MW or greater. There are five taconite companies, including Hibtac, in MP's LP class. The class also includes four paper companies.

Electric Service Agreements

Both the taconite and paper industries have special energy demands. They are energy-intensive and highly sensitive to fluctuations in world trade. MP, which is largely focused on these two volatile industries, has sought means of stabilizing energy supply and demand.

In the 1970's a practice of negotiating individual electric service agreements between each LP customer and MP evolved. Under these agreements, LP customers commit to take specified amounts of power for specified time periods (take-or-pay commitments), in exchange for a secure source of power. The LP customers are thus assured of the availability of power at the quantity contracted for, and MP is able to project what investment and construction will be necessary to meet future energy demands.

On February 28, 1978, MP and Hibtac entered into an electric service agreement.

Economic Downturn in the 1980's

In the 1980's the American steel industry suffered a severe economic downturn. Taconite pellet production was cut back, and energy demand was greatly reduced. Taconite companies were faced with commitments to pay for energy which would not be needed.

Recognizing the change in circumstances, MP and its LP customers, including Hibtac, negotiated amendments to their electric service agreements. MP allowed the financially pressed customers to reduce their energy commitments. In exchange, the customers agreed to extend the termination dates of their initial contracts. As an added feature to the renegotiated contracts, MP allowed LP customers to take power above their new commitments, when needed, without making long-term commitments for this "excess" power. The renegotiated contracts were approved by the Commission.

MP Rate Case

In 1987 MP filed for a general rate increase in Docket No.
E-015/GR-87-223. As a result of this proceeding, a special rate for excess power was added to the LP tariff. Large Power customers were given a $5.00 per kW discount on all power requirements in excess of their take-or-pay commitments. The Commission approved the excess demand discount because it would encourage LP customers to increase production in a time of abundant production capacity. Customers would receive a favorable price and MP would be able to derive revenues from excess capacity that would otherwise remain idle.

HIBTAC'S CURRENT PROPOSED AMENDMENT

As a result of their latest negotiations, MP and Hibtac have proposed an extension of their electric service agreement by seven months, from October 1, 1995 to April 30, 1996. The current take-or-pay commitment of 80 MW would remain level during that time. In addition, the parties negotiated a 48 month demand increase of 40 MW, from June 1, 1990 to June 1, 1994. Hibtac would also commit to 40 MW of excess power from June 1, 1990 until December 31, 1991. In exchange for Hibtac's commitments, MP would pay Hibtac a cash payment of $2.2 million. MP would also price the excess energy at the "firm energy" rate, rather than the incremental rate. This would represent a small discount on the energy charge.

THE DEPARTMENT RECOMMENDATION

In judging the advisability of the proposed MP/Hibtac amendment, the Department applied the long-term revenue stability standard. Under this standard, a proposed contract amendment must contribute to the utility's long-term revenue stability in order for it to be beneficial for utility ratepayers. Only if the overall picture adds up to increased long-term revenue stability will the Department approve the proposal.

In order to assess long-term revenue stability, the Department looks at the size of the contract commitment and the length of the proposed contract. In this case, the proposed amendment will mean an additional 7 months of take-or-pay commitment by Hibtac. There will be a 48 month increase of 40 MW over the current demand level. According to the Department's analysis, these benefits outweigh the discounts given to Hibtac on its excess demand and the $2.2 million cash outlay from MP. The overall picture is an increase in MP revenue stability and the Department therefore recommended approval of the proposal.

COMMISSION ACTION

The Commission agrees with the Department that the proposed Hibtac/MP contract amendment is of benefit to MP ratepayers. The payment-to-revenue cost benefit ratio of .07 is favorable. There is no discrimination among similar customers, since MP is currently offering similar contracts to all its LP customers. MP and its ratepayers will benefit from short-term revenue enhancement due to the increased excess demand commitment. The Commission will approve the proposed amendment.

While the Commission agrees with the Department's overall approval of the proposed amendment, the Commission also shares a Department concern regarding the excess demand discount. As discussed previously, this discount first came into effect during the 1987 MP rate case, when MP was experiencing a time of abundant capacity. The discount was partially an incentive to promote increased customer usage. Since that time, MP's capacity level has decreased, both as a result of the sale of capacity to other utilities and to increased service to LP customers. While the Commission finds that the excess demand discount is still justified in this particular set of facts, it may be necessary to consider elimination of the excess demand discount at some future time.

The Commission is also greatly concerned about the effects on MP ratepayers of the large cash payment to Hibtac. The Commission has approved the payment as part of an overall negotiated contract which is generally favorable to MP ratepayers as well as to Hibtac and MP shareholders. In approving the cash payment, however, the Commission is not expressing any indication of its treatment of this issue in future rate case proceedings. Any ratemaking issues raised by MP due to the cash payment will be examined closely at the time of the rate case proceeding.

<u>ORDER</u>

1. Minnesota Power's April 2, 1990 petition requesting an amendment to the Hibbing Taconite Joint Venture/Minnesota Power electric service agreement is hereby approved.

2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)